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1976
ANNUAL REPORT

CANADIAN HYDROCARBONS LIMITED

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CANADIAN HYDROCARBONS LIMITED

1976 Annual Report

FINANCIAL AND OPERATING HIGHLIGHTS

FINANCIAL

	1976	1975
Net earnings	$ **5,341,000**	6,860,000
Funds from operations (excluding depletion on limited term oil and gas leases)	**13,256,000**	12,051,000
Gross revenue	**329,466,000**	301,200,000
Dividends on common shares	**1,282,000**	1,282,000
Per common share:		
Net earnings	**.93**	1.22
Cash dividends		
March	**.125**	.125
September	**.125**	.125
Long term debt	**64,204,000**	66,845,000
Total assets	**217,726,000**	214,101,000
Average number of common shares outstanding	**5,129,680**	5,129,680

OPERATING

	1976	1975
Propane and butane — gallonage	**198,041,000**	212,799,000
Gasoline and other petroleum products — gallonage	**237,691,000**	246,464,000
Natural gas — mcf	**18,342,000**	18,723,000
Electricity — kwh	**57,555,000**	54,257,000
Number of employees	**2,529**	2,745
Number of common shareholders	**2,814**	2,904

Gallonage figures are expressed in terms of Canadian gallons.

The Company, Canadian Hydrocarbons Limited, operating through subsidiaries is principally engaged in the marketing of propane, gasoline and light and residual oils; refining of petroleum products; operation of natural gas utilities; operation of an electrical utility; manufacture and supply of forest products; pipe and steel fabrication; interests in producing oil and natural gas properties; and exploration for and development of oil, natural gas and other minerals.

Contents

Annual Meeting

The Annual Meeting of the Company will be held at the Lakeview Room, Calgary Inn, 4th Avenue & 3rd Street S.W., Calgary, Alberta at 1:00 p.m., May 16, 1977.

Annual Report on Form 10-K

The SEC Annual Report Form 10-K for the year ended December 31, 1976 will be provided by mail upon receipt of a written request from any person who is a beneficial owner of Canadian Hydrocarbons Limited's common stock.

Such written requests should be directed: Anthony C. Rooney, Vice President, Finance, Canadian Hydrocarbons Limited, 700 Three Calgary Place, 355 Fourth Avenue S.W., Calgary, Alberta T2P 0J1

REPORT TO THE SHAREHOLDERS

Net earnings for the year ended December 31, 1976 were $5,341,000 or $.93c per common share compared with $1.22 per common share in 1975.

Revenues increased to $329,466,000 from $301,200,000; however, the $5,608,000 improvement in gross profit which resulted was offset by increased operating, selling and administrative expenses.

The expense of a cost reduction program implemented during the year is included in 1976; however, the full benefit of this program will not reflect until 1977 and subsequent years. In spite of reduced earnings, cash flow from operations decreased only 3% from 1975. The reduction in working capital of $4,157,000 reflects an increased annual investment in the shares of Canadian Homestead Oils Limited and net redemptions of term debt.

The notes to the consolidated financial statements contained in this report refer to certain significant transactions. Without these transactions earnings would have been 7c per share higher.

In April 1976, Mr. W. R. Loren joined the Company to manage the petroleum marketing and refining operations. For the past 30 years Mr. Loren has been associated with major oil companies in the U.S. where he has held senior management positions in all phases of petroleum marketing operations.

During the year, Robert G. Graham was appointed Chairman of the Board and President, and Wayne R. Harding and C. Roy Beenham were appointed Vice-Presidents, replacing R. A. Rich, Paul M. Marshall and Harold R. Allsopp who were formerly Chairman and Chief Executive Officer, President and Vice-President respectively.

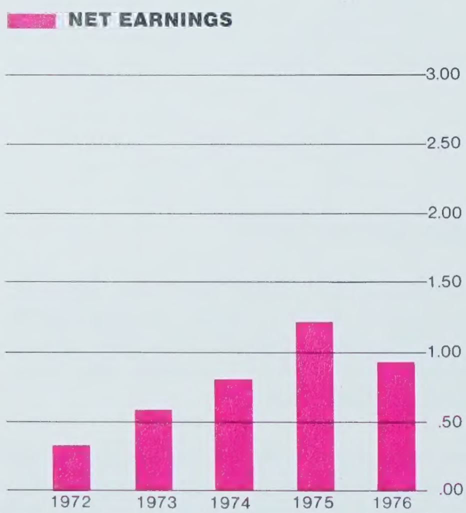
A review of operations of the major divisions follows, together with the Consolidated Financial Statements for 1976.

On behalf of the
Board of Directors

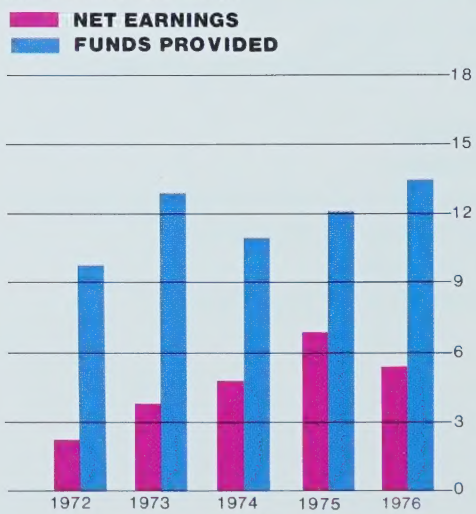
R. G. Graham

Chairman and President

NET EARNINGS
DOLLARS



NET EARNINGS AND FUNDS PROVIDED
(excluding depletion on limited term leases)
MILLIONS OF DOLLARS



PETROLEUM PRODUCTS, REFINING AND MARKETING

Revenue from petroleum products refining and marketing was $222,889,-000 in 1976 compared to $222,029,-000 in 1975. The profit margin realized in 1976 showed a modest increase over 1975; however, increases in operating expenses and unusual bad debt experience resulted in a contribution to net earnings from petroleum products, refining and marketing of $3,927,000 compared with $4,962,-000 in 1975.

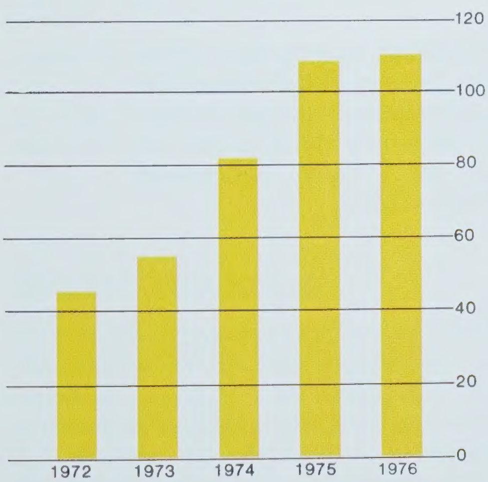
The Company operates three small crude oil refineries in the United States with aggregate capacity of approximately 14,400 barrels per day. Although the refineries operated slightly below 75% capacity, reflecting reduced availability of both domestic and foreign crude oil, production was marginally above 1975 levels. These facilities operate principally as a source of supply to the marketing division and continue to produce finished products below the cost of available purchased product.

In addition the company operates a natural gas processing plant in Montana and another in Alberta. The Montana gas processing plant operated profitably at approximately the same level as the previous year. Although the gas processing plant in Alberta again operated substantially below maximum capacity, the Company benefited from increased wellhead prices, and this facility continues to be profitable.

Marketing operations involve distribution of propane, gasoline and oils in the Provinces of British Columbia, Alberta, Saskatchewan, Manitoba, Ontario and Quebec and the States of Washington, Oregon, Idaho, Montana and North Dakota. Propane is primarily distributed to numerous domestic and small commercial and industrial customers after bulk transfer from its source to company-operated outlets. Gasoline and fuel oils are sold to major wholesale accounts and through company-operated retail outlets.

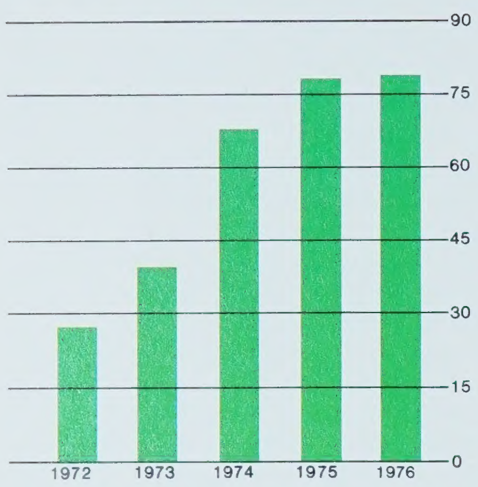
During 1976, propane sales in Canada decreased by 7.6%. Volumes in Western Canada declined substantially reflecting both warmer than normal weather and the continuing expansion of natural gas service in Alberta pursuant to the Provincial government's rural gasification program. Loss of low margin export sales out of Eastern Canada also contributed to the decrease.

GASOLINE, FUEL OILS AND OTHER REFINED PRODUCTS REVENUE
MILLIONS OF DOLLARS

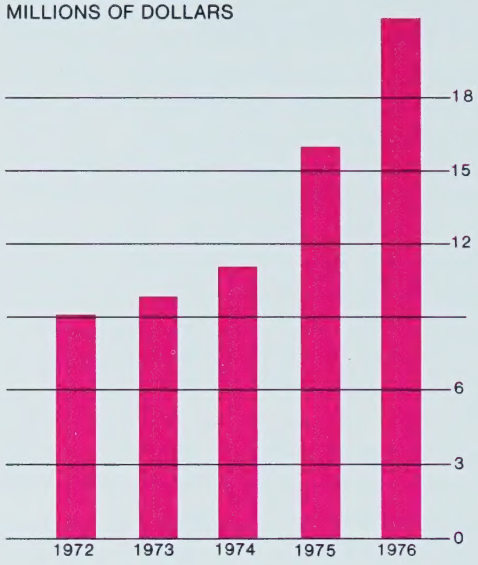


One of the Company's self-service Vista service stations' with new digital solid state field dispensers, located in the Pacific North West.

PROPANE REVENUE
MILLIONS OF DOLLARS



UTILITIES REVENUE
MILLIONS OF DOLLARS



Propane sales in the United States declined moderately; however, profits did not decline due to an improvement in average margins realized.

In Canada, gasoline sales were up slightly from 1975 and a nominal improvement in margins resulted in a small increase in profits.

In the United States, gross income from gasoline sales increased on sales volumes equal to only 89% of 1975. This increase was primarily achieved by a reduction of sales to low margin major wholesale accounts and increased sales through up-graded high margin retail outlets.

UTILITIES

The Company's utility division includes natural gas distribution systems in 94 communities and 26 rural areas throughout Manitoba, Alberta and British Columbia, and distributes electrity in the City of Yellowknife in the Northwest Territories.

Revenue from these operations was $23,981,000 in 1976 compared with $17,981,000 in 1975, and contribution to net earnings was $2,038,000 in 1976 compared to $1,988,000 in the previous year.

Natural gas distribution was adversely affected by weather during 1976. Approximately 50% of the annual natural gas sales are in Alberta and British Columbia where the weather was approximately 10½% warmer than in 1975. However, the revenue from more than 3,500 additional customers significantly exceeded the loss due to weather. Revenues were further increased by approximately $350,000 as a result of an interim rate order issued by the Public Utilities Board of Alberta whereby the Company was permitted to recover a revenue deficiency from the previous year. In Manitoba, the annual volume sold improved slightly due to a modest increase in the number of customers served.

Increased expenses in all areas of the utility division were slightly higher than the total improvement in gross income so that the division's contribution to consolidated net income decreased marginally from 1975.

STEEL PRODUCTS

Thompson Pipe and Steel Company, located in Denver, Colorado, is the steel products division of the Company. During October 1976 Thompson added a spiral steel mill with capability of manufacturing steel pipe to a diameter of 10 feet. This new mill, in addition to the older conventional facility, will enable the Company to continue expansion of custom engineered production.

During 1976 engineered products accounted for approximately 80% of total sales. The company also manufactures corrugated steel pipe and acts as distributor for equipment utilized in waterworks projects. During 1976 Thompson increased net earnings by 44% to $1,172,000 on total sales of $17,460,000. In 1975 earnings were $813,000 on sales of $17,957,000.

Sales of irrigation products were discontinued because the Company's product line could not be economically expanded and the available products could not support the costs of competitive distribution. The loss of these sales was substantially offset by increases in higher margin sales of engineered products and corrugated steel pipe.

Average gross profit margins improved during 1976 reflecting both the change of sales mix and lower manufacturing costs resulting from programs emphasizing cost control and improvement in manufacturing.

Improvement in selling and administrative procedures enabled the Company to reduce operating expenses by 10% during 1976.

FOREST PRODUCTS

This division commenced in 1974 with the acquisition of two companies located in Oregon. It is involved in the wholesale trading of plywood and lumber and the manufacture of plywood. Facilities consist of a wholesale trading office in Portland, a reloading centre at Redding, California and a plywood mill in Medford, Oregon.

During 1975 wholesale trading accounted for approximately 65% of $67,336,000 revenue compared with approximately 45% of 1975 revenues of $44,317,000. Typically this form of trading yields low gross margins; accordingly, substantial changes in annual sales volumes generate relatively minor changes in gross income.

Although the profitability of the plywood manufacturing company improved considerably during 1976, consolidated operating earnings of the division were relatively insignificant. In view of the accumulated losses realized in the forest products division since acquisition, the portion of the original purchase price described in the financial statements as "excess of cost over net book value of assets acquired, less amortization" which is generally recorded in anticipation that future earnings will justify such value has been written off and is included as "depreciation and amortization" in the consolidated financial statements. After providing for this write off in the amount of $1,350,000, the forest products division realized a net loss of $1,168,000 compared with an operating loss of $337,000 in 1975.

Thompson Pipe & Steel Company's newly installed spiral pipe mill, one of the few with the capacity to manufacture 123" outside diameter steel pipe.

EXPLORATION AND DEVELOPMENT

Most of the Company's exploration and development for petroleum and natural gas is carried out through its investment in Canadian Homestead Oils Limited.

The Company is party to an agreement with Homestead under which it may acquire shares of Homestead at the rate of one share for each $6.67 spent in exploration and drilling operations on Homestead properties. As at December 31, 1976, the company owned 2,746,688 shares of Homestead of which 9,050 were pending issue, and was entitled to receive an additional 115,737 shares upon payment of an account due to Homestead in the amount of $771,967. Upon receipt of these additional treasury shares, the company will own approximately 45% of the total outstanding common shares of Homestead. Under the agreement $5,346,000 remains to be spent in annual instalments of not less than $1,500,000 nor more than $3,070,000.

At the conclusion of the agreement the Company will own or control approximately 50% of Homestead's then outstanding shares.

At December 31, 1976 Homestead's land holdings totalled 20.2 million gross acres equal to 6.1 million net. A significant portion of this acreage is located in the Arctic Islands and Hudson Bay regions of Canada and in Kenya, East Africa.

Proven reserves at December 31, 1976, excluding the Drake Point and Hecla fields in the Arctic Islands and before providing for Crown royalty, were 178 billion cubic feet of natural gas and 11 million barrels of oil and natural gas liquids.

During 1976, Canadian Homestead participated in the drilling of 50 wells of which 13 were oil wells, 21 gas wells and 16 were dry holes.

Homestead has concentrated its activities in the following areas.

90,000 gallon propane barge owned by the Company, servicing Vancouver Island and the British Columbia mainland coastal areas without outside road access.

Alberta

Botha

This area of northwestern Alberta, in which Homestead recently acquired a 25% interest in 8,160 acres of petroleum and natural gas rights, is currently the site of Slave Point gas development. Two wells have been completed to date and additional drilling will be conducted in the ensuing weeks in order to further develop and evaluate this pool.

Heart River

The Company holds a 45% interest in an 8,000 acre license contiguous to the Heart River gas field and has entered into arrangements whereby interests can be acquired in additional lands through drilling. To date, two earning wells have been drilled.

Rosevear

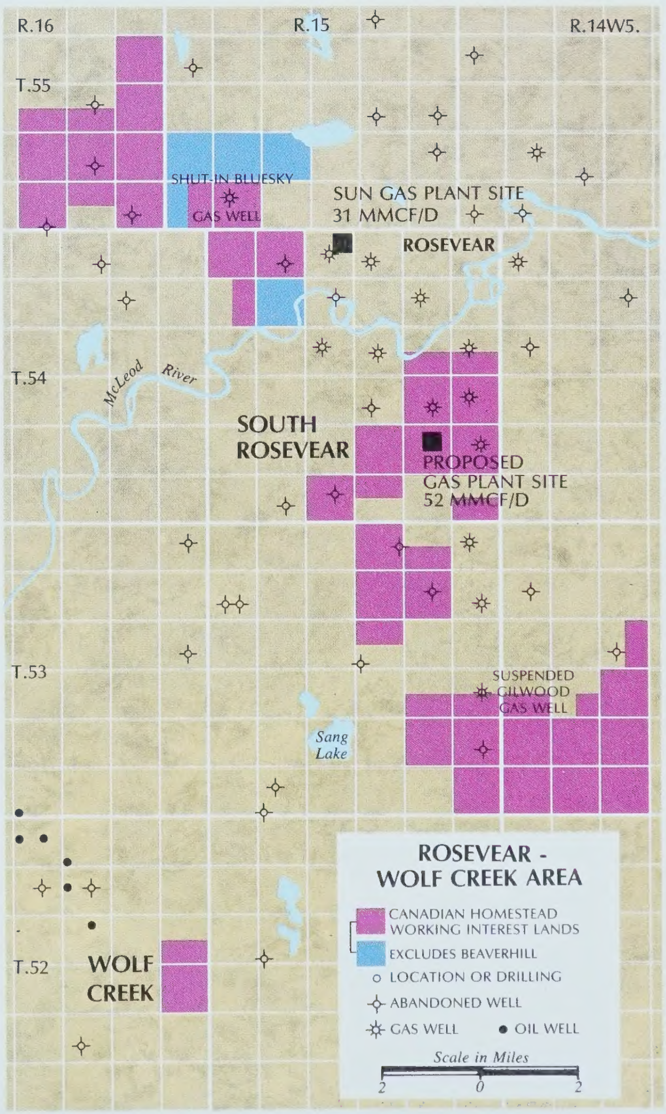
In 1975, this area of west central Alberta was the focal point for exploration and development activity by Homestead. During the past year, however, drilling activity has subsided and attention has been devoted to planning for the production of the gas reserves which have been discovered to date. The Company had interests in two wells drilled during 1976, both of which were non-productive and abandoned. Commencement of construction of a $25 million plant, capable of processing upwards of 50 million cubic feet of raw gas per day, is currently suspended pending negotiation of a gas sales contract. Homestead will have approximately a one-third share in this facility.

Wolf Creek

A one-third interest is held in a 960 acre lease located southwest of the Rosevear development. Geophysical work conducted to date indicates this prospect to have similar characteristics to Rosevear and an attempt will be made to have it tested in 1977.

Arctic Islands

During 1976, two extension wells were drilled from ice platforms located eight and fifteen miles offshore from the Hecla discovery area on the Sabine Peninsula of Melville Island. Both tests were productive and served to extend the western limits of the Hecla field. One well encountered a new gas pool in the deeper Bjorne sand. It was the first discovery in the Arctic Islands from this formation and indicates that the Hecla field could be productive from at least two geological zones.



British Columbia

Prophet River

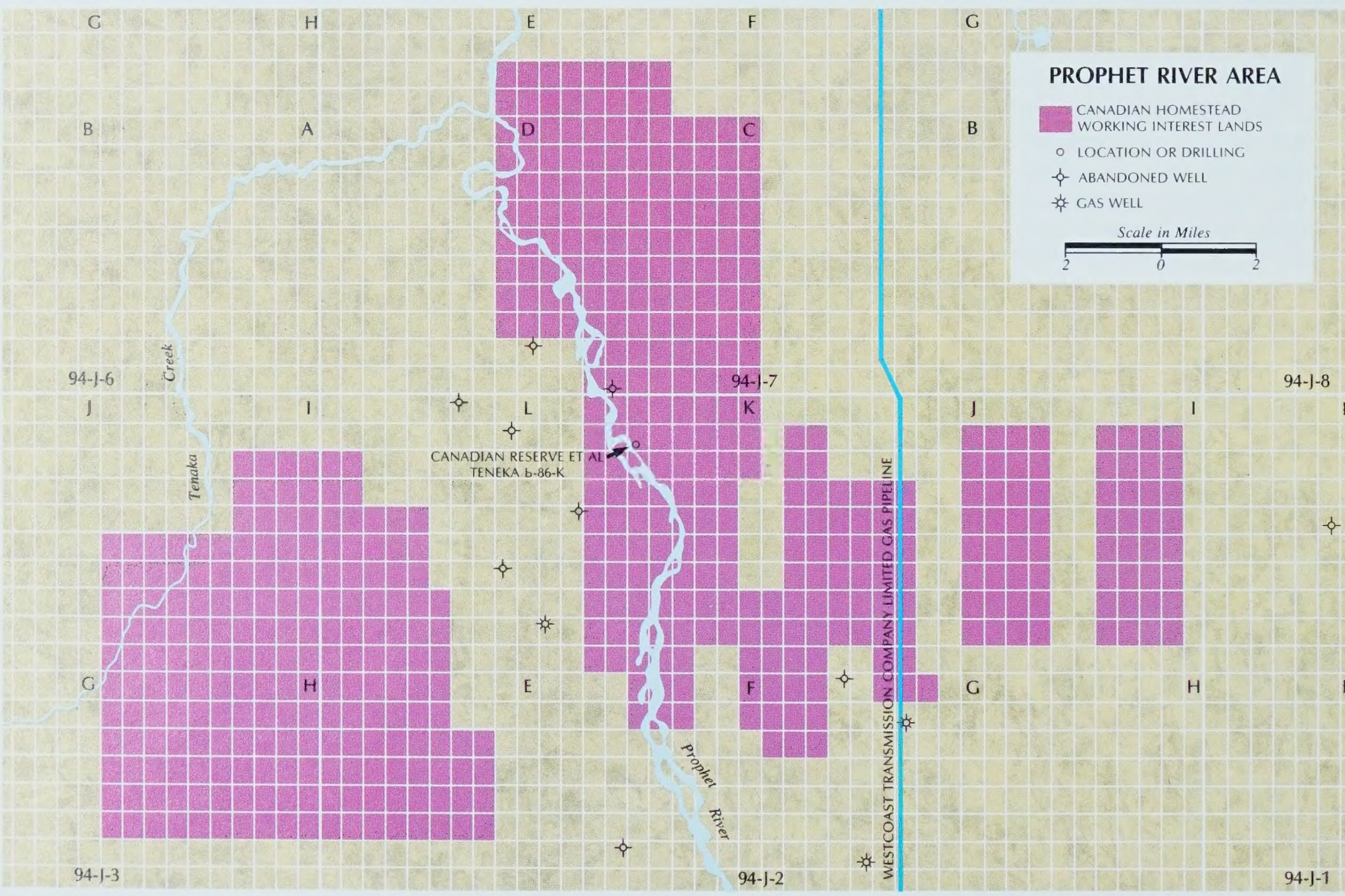
The Company holds varying interests in 88,000 acres in this area of northeastern British Columbia where a Middle Devonian test is currently being drilled.

Niteal

In the Niteal region of northeastern British Columbia, a one-third interest in 67,000 acres has been acquired. This is an Upper Devonian gas prospect on which one well has been drilled and is awaiting testing, while another is presently drilling.

Texas

In the State of Texas, the Company's subsidiary, Canadian Admiral Oils Co. has, since 1975, participated in a total of 34 wells, resulting in 19 oil wells and 1 gas well.



FIVE YEAR COMPARATIVE STATISTICS

(thousands of dollars except equity per share and shares outstanding)

	1976	1975	1974	1973	1972
Working capital	**$ 15,736**	$ 19,893	$ 15,929	$ 20,470	$ 18,203
Funds from operations (excluding depletion on limited term leases)	**13,256**	12,051	11,212	12,890	9,466
Purchase of fixed assets (net)	**10,815**	7,430	10,142	18,508	14,013
Fixed assets including cost of shares of subsidiaries over net book value	**114,249**	112,971	111,734	108,643	94,439
Long term debt	**64,204**	66,845	67,670	71,184	60,565
Preferred shares	**9,972**	10,144	10,307	10,475	10,643
Common shareholders' equity	**62,308**	57,194	47,770	42,835	39,382
Common shareholders' equity per share	**12.15**	11.15	9.31	8.35	7.92
Number of common shares outstanding at year-end (thousands)	**5,130**	5,130	5,130	5,130	4,974

EARNINGS PER SHARE AND COMMON STOCK PRICE RANGE

	Earnings Per Share		Common Stock Price Range (in dollars)			
	1976	1975	1976		1975	
			High	Low	High	Low
Quarter						
First	**$ .61**	$ .46	**8 1/4**	**5 5/8**	5 1/4	3 1/4
Second	**(.01)**	.09	**9 1/2**	**7 1/4**	6 3/4	5 1/4
Third	**.02**	.14	**10**	**7 1/8**	7 3/4	5 1/2
Fourth	**.31**	.53	**8 1/8**	**6 3/8**	6 1/8	5 1/8
Year ended	**$ .93**	$1.22				


MONTANA
N
DAKOTA
IDAHO
COLORADO

MAJOR FACILITIES AND DISTRIBUTION LOCATIONS

FRANCHISES	
Gas	121
Electrical	1
PROPANE AND PETROLEUM PRODUCT OUTLETS	
Retail Outlets	204
Consignee Operator Outlets	192
Storage Points	18
PROCESSING PLANTS AND REFINERIES	8
FOREST PRODUCTS OUTLETS	5
RAILWAY TANK CARS	209
HIGHWAY TRANSPORTS	
Propane — Tractors	25
— Trailers	54
Petroleum Products	11
DELIVERY TRUCKS	
Propane	316
Petroleum Products	27
SERVICE VEHICLES	600
EMPLOYEES	2,529
CUSTOMERS	
Propane & Utilities	255,431
MILES OF PIPELINE	
Transmission & Distribution	5,856
PROPANE STORAGE FACILITIES	
Above Ground	50,400,000
Under Ground	19,000,000

LEGEND

- ★ REFINERIES/PROCESSING PLANTS
- ● PROPANE
- ▲ GASOLINE
- ■ GASOLINE, LIGHT OILS, PROPANE
- ○ UTILITIES
- □ FOREST PRODUCTS
- △ METAL FABRICATING

CONSOLIDATED STATEMENT OF EARNINGS

Years ended December 31, 1976 and 1975
(thousands of dollars except per share figures)

	1976	1975
Revenue	**$329,466**	$301,200
Expenses		
Cost of sales	**250,243**	226,082
Operating, selling and administrative expenses	**48,504**	42,906
Interest and expense on long term debt	**5,646**	5,728
Other interest expense	**1,781**	1,920
Depreciation, depletion and amortization (Note 7)	**11,620**	11,057
Minority interest in earnings of subsidiaries	**320**	294
	318,114	287,987
Earnings before income taxes	**11,352**	13,213
Income taxes	**6,802**	7,014
Earnings before equity in net earnings of affiliate	**4,550**	6,199
Equity in net earnings of affiliate	**791**	661
Net earnings for the year	**$ 5,341**	$ 6,860
Net earnings per common share	**$ .93**	$ 1.22

(Based on average number of shares outstanding)

See accompanying notes.

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

Years ended December 31, 1976 and 1975
(thousands of dollars)

	1976	1975
Funds Provided		
Funds from operations	$15,736	$16,203
Disposal of fixed and other assets	1,493	1,930
Additional long term debt	6,395	13,710
Contributions in aid of construction	1,864	4,556
	25,488	36,399
Funds Applied		
Additions to fixed assets	14,171	13,916
Dividends on preferred and common shares	1,869	1,877
Reduction of long term debt	9,149	14,546
Investment in Canadian Homestead Oils Limited	3,082	1,534
Redemption of first and second preferred shares	171	163
Additions to notes and mortgages	355	(20)
Customer deposits	208	—
Other	640	419
	29,645	32,435
Increase (decrease) in working capital	$(4,157)	$ 3,964
Changes in working capital represented by		
Increase (decrease) in current assets		
Cash and term deposits	$(6,426)	$ 498
Accounts and notes receivable	1,888	10,022
Inventories	2,363	(3,492)
Prepaid expenses	459	(85)
	(1,716)	6,943
Increase (decrease) in current liabilities		
Bank loans	(2,728)	1,352
Accounts payable and accrued charges	4,552	2,871
Income taxes payable	(358)	(2,468)
Current maturities of long term debt	379	1,211
Deferred income	119	13
Deferred income taxes	477	—
	2,441	2,979
Increase (decrease) in working capital	$(4,157)	$ 3,964

See accompanying notes.

CONSOLIDATED BALANCE SHEET December 31, 1976 and 1975
(thousands of dollars)

ASSETS

	1976	1975
Current		
Cash	$ 1,554	$ 5,876
Short term deposits	7,563	9,667
Accounts and notes receivable	45,819	43,931
Inventories	26,022	23,659
Prepaid expenses	1,267	808
	82,225	83,941
Investments		
Shares of Canadian Homestead Oils Limited (Note 1)	18,002	14,308
Notes and other	2,307	1,834
	20,309	16,142
Fixed (Note 2)	159,938	157,010
Less accumulated depreciation and depletion	49,509	49,171
	110,429	107,839
Other		
Debt financing and other deferred charges less amounts written off	943	1,047
Cost of shares of subsidiaries over carrying value at dates of purchase (Note 7)	3,820	5,132
	4,763	6,179
	$217,726	$214,101

On behalf of the Board:

ROBERT G. GRAHAM, Director

ALAN SWEATMAN, Q.C., Director

See accompanying notes.

LIABILITIES

	1976	1975
Current		
Bank loans ($11,275,000 secured)	$ 18,890	$ 21,618
Accounts payable and accrued charges	37,410	32,858
Income taxes payable	2,943	3,301
Current maturities of long term debt (Note 3)	5,330	4,951
Deferred income	1,439	1,320
Deferred income taxes	477	—
	66,489	64,048
Long term debt (Note 3)	64,204	66,845
Deposits	291	505
Deferred income taxes	9,257	10,140
Minority interest in subsidiaries (Note 4)	5,205	5,225
SHAREHOLDERS' EQUITY		
Capital (Note 5)		
Authorized		
250,000 5½% cumulative redeemable first preferred shares, par value $20		
4,000,000 6% cumulative redeemable second preferred shares, par value $25		
14,000,000 common shares, no par value		
Outstanding		
207,755 first preferred shares (1975 - 211,455 shares)	4,155	4,229
232,700 second preferred shares (1975 - 236,600 shares)	5,817	5,915
5,129,680 common shares	24,236	24,236
	34,208	34,380
Contributions in aid of construction	10,949	9,307
Retained earnings	27,123	23,651
	72,280	67,338
Commitments and contingencies (Notes 1 and 9)		
	$217,726	$214,101

CONSOLIDATED STATEMENT OF RETAINED EARNINGS

Years ended December 31, 1976 and 1975
(thousands of dollars)

	1976	1975
Balance at beginning of year		
As previously stated	**$24,134**	$19,723
Deduct		
Adjustments and draw-downs of deferred income taxes	**483**	1,055
As restated	**23,651**	18,668
Add net earnings for the year	**5,341**	6,860
	28,992	25,528
Deduct dividends		
Preferred shares	**587**	595
Common shares	**1,282**	1,282
	1,869	1,877
Balance at end of year	**$27,123**	$23,651

See accompanying notes.

AUDITORS' REPORT

To the Shareholders of
Canadian Hydrocarbons Limited

We have examined the consolidated balance sheet of Canadian Hydrocarbons Limited as at December 31, 1976 and 1975 and the consolidated statements of earnings, retained earnings and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at December 31, 1976 and 1975 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles applied on a consistent basis during the period.

Calgary, Canada.
March 1, 1977.

Clarkson, Gordon & Co.
Chartered Accountants.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 1976 and 1975

Summary of principal accounting policies

Consolidation

The consolidated financial statements include the accounts of Canadian Hydrocarbons Limited and its subsidiary companies and reflect earnings of subsidiaries since acquisition. The financial statements have been prepared in accordance with generally accepted accounting principles in Canada which differ in certain respects with accounting principles in the United States. The effects of these differences are not material.

Foreign currency translation

Foreign currencies have been translated into Canadian dollars on the following bases:

(a) Current assets and current liabilities at the rate of exchange in effect at the balance sheet date.

(b) Non current assets and liabilities at historical rates.

(c) Revenue and expense items at average rates prevailing throughout the year.

Gains or losses on translation are charged to earnings.

Business combinations

Companies acquired have been accounted for as purchases. Purchase prices have been allocated to assets based on appraisals and any remaining difference is recorded as "cost of shares of subsidiaries over carrying value at dates of purchase". No significant acquisitions were concluded in 1976 or in 1975.

Inventories

Inventories are priced at the lower of cost (first-in, first-out) or replacement cost except for certain United States subsidiaries which price petroleum products on the last-in, first-out method. Net earnings for 1976 were increased by approximately $50,000, as a result of a decrease in LIFO inventory quantities, (1975 - $500,000).

Investments

The Company accounts for its investment in Canadian Homestead Oils Limited by the equity method. Investments in other companies are recorded at lower of cost or market with income recorded only as dividends are received.

Fixed Assets, depreciation and depletion

Fixed assets are recorded at cost, which policy includes the full cost method of accounting for oil and gas properties. Depreciation is provided on a straight line basis at rates varying from 2% to 25% which are designed to amortize the cost of the assets over their estimated useful lives. Amortization of contributions in aid of construction is provided in amounts that correspond with depreciation of the related assets.

Oil and gas properties and royalty interests are depleted on a unit of production method based on estimated remaining reserves. Limited term interests in oil and gas leases are depleted over their remaining terms.

Income taxes

Since 1969 the Company, with the exception of its public utility subsidiaries, has accounted for income taxes by the tax allocation method whereby the income tax provision is based on the earnings reported in the accounts. Unrecorded deferred income taxes at 1969 are charged to retained earnings as drawdowns occur. Public utility subsidiaries record only income taxes payable in accordance with regulatory requirements. At December 31, 1976 unrecorded deferred income taxes with respect to such subsidiaries amount to approximately $1,733,000, (1975 - $1,695,000).

1. Investment in Canadian Homestead Oils Limited

At December 31, 1976 the Company held a total of 2,862,425 shares of Canadian Homestead Oils Limited representing 45% of the outstanding common shares of Homestead. At that date the quoted market value was $18,248,000.

Additional shares are being acquired under terms of an agreement which commenced January 1, 1975 between Canadian Propane Gas & Oil Ltd. (a wholly-owned subsidiary) and Homestead, whereby Canadian Propane is committed to an expenditure of $9,212,000 and will receive as consideration one share of Homestead for each $6.67 so expended. Canadian Propane is required to expend annually a minimum of $1,500,000, but not more than $3,070,000 until the full commitment of $9,212,000 has been met. In 1976 expenditures amounted to $2,332,000 and at December 31, 1976 $5,346,000 is remaining under the commitment.

2. Fixed assets

	(In Thousands)	
	1976	**1975**
Customers' installations	**$ 32,770**	$ 31,611
Transmission lines and distribution systems	**40,349**	35,881
Buildings and equipment	**39,438**	35,703
Refineries and gas plants	**11,604**	11,073
Automotive equipment	**11,605**	11,181
Oil, gas and mining properties and equipment	**9,968**	9,470
Oil and gas royalties	**7,099**	7,099
Limited term oil and gas leases	**2,001**	10,009
Land	**5,104**	4,983
	159,938	157,010
Deduct		
Accumulated depreciation	**41,884**	37,011
Accumulated depletion	**7,625**	12,160
	49,509	49,171
	$110,429	$107,839

3. Long term debt

	1976 (In Thousands)		1975 (In Thousands)	
Parent				
Convertible interest free promissory note			$ 350	U.S.
7% Promissory Note due 1981	**$ 1,706**		2,047	
9% Promissory Note due 1983	**3,325**		3,800	
Subsidiaries				
7¾% to 10½% Bank Loans due on various dates to 1979	**6,515**	U.S.	4,784	U.S.
5% to 7% Promissory Notes due 1978 and 1980	**3,266**	U.S.	4,399	U.S.
6% to 6½% Sinking Fund Debentures due on various dates from 1981 to 1985	**8,979**		9,379	
6½% Sinking Fund Debentures due 1987	**2,632**	U.S.	2,742	U.S.
7¼% Promissory Note due 1989	**3,680**	U.S.	3,760	U.S.
5% Subordinated Debentures due 1989	**4,091**	U.S.	4,321	U.S.
10½% Promissory Note due 1995 ($3,000,000 U.S.)	**2,959**			
10¾% Promissory Note due 1995	**3,000**	U.S.	3,000	U.S.
5% Subordinated Note due 1990	**4,389**	U.S.	4,702	U.S.
9⅝% Sinking Fund Debentures due 1977 to 1991	**7,000**	U.S.	7,000	U.S.
8⅝% Promissory Notes due 1993	**4,410**		4,455	
9.8% to 10.25% Bank Productions Loans due on various dates to 1981	**9,995**		14,247	
Notes and Mortgages, due on various dates	**3,587**		2,810	
	69,534		71,796	
Deduct current maturities included in current liabilities	**5,330**		4,951	
	$64,204		$66,845	

Current maturities included in current liabilities do not include estimated repayments of bank production loans in 1977. Long term debt repayments, including estimated bank production loan repayments, in each of the five years subsequent to December 31, 1976 are as follows: 1977 - $5,630; 1978 - $8,873; 1979 - $5,863; 1980 - $5,215 and 1981 - $10,481.

Long term debt repayable in U.S. currency is recorded at the historical rate of $1.00 U.S. = $1.00 Canadian.

Financing expenses are being amortized over the terms of the issues.

4. Minority interest in subsidiaries

	1976 (In Thousands)	1975 (In Thousands)
Preferred shares of Great Northern Gas Utilities Ltd.	**$2,251**	$2,337
Other companies	**2,954**	2,888
	$5,205	$5,225

5. Capital

Under provisions relating to the outstanding preferred shares, the Company is required to purchase annually for redemption 3,500 first preferred shares and 3,900 second preferred shares, if available on the open market, at prices not exceeding their par value. In addition, the first and second preferred shares are redeemable by the Company at any time at prices not exceeding $21.10 and $26.50 per share respectively.

To December 31, 1976, the Company has redeemed 42,245 first preferred shares of an aggregate par value of $844,900 and 27,300 second preferred shares of an aggregate par value of $682,500. Accordingly, under provisions of the Canada Corporations Act, consolidated retained earnings includes $1,527,400 designated as "capital surplus".

Under stock option plans adopted in prior years, the Company may grant options to officers and employees to purchase common shares. Generally, options are exercisable cumulatively at the rate of 25% annually beginning one year from date of granting and expiring five years from such date.

	Qualified Stock Option Plan		Non-Qualified Stock Option Plan	
	Price per Share	Shares Optioned	Price per Share	Shares Optioned
1975				
Options outstanding January 1......	$7.50 - $10.00	105,125	$10.625	3,000
Options cancelled	$7.50 - $ 9.00	(18,800)	$10.625	(1,000)
Options outstanding December 31 ..	$7.50 - $10.00	86,325	$10.625	2,000
1976				
Options granted	$8.375	5,000		
Options cancelled	$7.50 - $ 8.00	(32,000)	$10.625	(2,000)
Options outstanding December 31 ..	$7.50 - $10.00	59,325		Nil

At December 31, 1976, 161,375 common shares were reserved for the granting of options in the future under the Qualified Stock Option Plan.

6. Crude oil cost of sales

Certain of the Company's United States subsidiaries involved in refining operations are entitled to receive payments under a U.S. Government program which averages the cost of crude oil purchased by refiners from domestic and foreign sources. The Company purchased a greater proportion of higher priced crude than the national average and, therefore, is "entitled" to receive payments under the program to bring its average cost closer to the national average. In years prior to 1976 the amount of the entitlement payments could not be estimated with reasonable accuracy. In 1976 such estimates can be made reliably and accordingly, the estimated payments to which the subsidiaries are entitled have been accrued resulting in an increase in net earnings of approximately $470,000.

7. Amortization of excess purchase costs

One of the Company's subsidiaries, Gold Rey Forest Products, Inc. is engaged primarily in the wholesale marketing and warehouse storage of plywood and lumber products. The marketing and distribution of forest products is a highly competitive business and the net earnings, since acquisition, of the subsidiary have not supported the excess cost of shares over the recorded carrying value of the subsidiary's net assets at date of purchase. As a result management has determined that the unamortized balance of this excess cost has been permanently impaired, and accordingly, $1,350,038 ($.26 per share) has been charged to earnings in 1976.

8. **Remuneration of Directors and Officers**

During the year the Company had twenty directors and eleven officers (1975 - fourteen directors and seven officers) who received the following remuneration:

	As Directors		As Officers	
	1976	1975	1976	1975
	(In Thousands)		(In Thousands)	
From the Company	**$39**	$43	**$306**	$331
From Subsidiaries	**4**	6	**77**	90
	$43	$49	**$383**	$421

Two officers, who were also directors, received no remuneration in their capacity as directors of the Company.

9. **Commitments and contingencies**

In addition to the commitment outlined in Note 1, the Company has entered into long term contracts to lease certain assets at annual rentals of approximately $1,801,000, expiring for the most part over a term of nineteen years from December 31, 1976.

Subsidiaries of the Company received income tax reassessments for the year 1971 disallowing the cost of limited term interests in oil and gas leases as a deduction from income. In the event that years subsequent to 1971 are reassessed on a similar basis the total estimated liability at December 31, 1976 amounts to $3,300,000.

The Company is filing Notices of Appeal to the reassessments. If the appeals are unsuccessful approximately $2,400,000 will be charged to earnings and to deferred income taxes in the years prior to 1975 and approximately $400,000 and $500,000 will be charged to earnings in the years 1975 and 1976 respectively. In view of these appeals no liability for the above amount has been provided.

10. **Anti-Inflation legislation**

Under the federal government's Anti-Inflation program (presently scheduled to be in force until December 31, 1978) the Company is subject to mandatory compliance with legislation which controls prices, profit margins, employee compensation and shareholder dividends. Petroleum and natural gas prices which are subject to the Petroleum Administration Act and utility revenues which are subject to rulings by a provincial regulatory agency are exempt from the application of this program.

11. **Replacement cost (unaudited)**

In compliance with rules of the Securities and Exchange Commission, the Company has estimated replacement cost information for inventories, certain fixed assets, cost of sales and depreciation. Information on replace-cost is disclosed in the Company's annual report on Form 10-K filed with the Securities and Exchange Commission.

12. **Quarterly financial data (unaudited)**

Summarized quarterly financial data (in thousands of dollars except for per share amounts) for the year 1976 is as follows:

	Three Months Ended			
	March 31	June 30	Sept. 30	Dec. 31
Net sales	$85,382	$68,066	$75,802	$89,790
Gross profit	$19,698	$13,934	$13,644	$21,521
Net earnings	$ 3,280	$ 84	$ 231	$ 1,746
Net earnings (loss) per common share	$ .61	$ (.01)	$ .02	$ .31

FIVE YEAR SUMMARY OF OPERATIONS

SUMMARY OF CONSOLIDATED STATEMENTS OF EARNINGS for the years ended December 31

(in thousands of dollars, except where amounts are given on a per share basis)

	1976	1975	1974	1973	1972
REVENUE	**$329,466**	$301,200	$246,147	$138,342	$106,656
EXPENSES					
Cost of sales	**250,243**	226,082	176,916	82,281	63,088
Operating, selling and administrative expenses	**50,285**	44,826	39,157	27,113	23,084
Interest and expense on long term debt	**5,646**	5,728	5,397	4,344	3,536
Depreciation and depletion	**11,620**	11,057	12,561	15,382	11,335
Minority interest in earnings of subsidiaries	**320**	294	329	272	251
	318,114	287,987	234,360	129,392	101,294
EARNINGS					
Earnings before income taxes	**11,352**	13,213	11,787	8,950	5,362
Income taxes	**6,802**	7,014	6,868	4,981	2,784
Earnings before equity in net earnings of affiliate	**4,550**	6,199	4,919	3,969	2,578
Equity in net earnings of affiliate	**791**	661	(38)	(328)	(294)
Net earnings	**5,341**	6,860	4,881	3,641	2,284
Dividends on preferred shares	**586**	595	605	614	624
Net earnings applicable to common shares	**$ 4,755**	$ 6,265	$ 4,276	$ 3,027	$ 1,660
PER SHARE INFORMATION					
Earnings per common share	**$ .93**	$ 1.22	$ .83	$ .60	$ .33
Dividends per common share	**.25**	.25	.25	.25	.25

REVENUE BY LINES OF BUSINESS

	1976	1975	1974	1973	1972
Gasoline and other petroleum products	**$109,599**	$107,362	$ 81,044	$ 55,515	$ 44,593
Propane	**78,194**	78,019	68,424	39,463	27,269
Natural gas and electricity	**21,502**	15,846	11,275	10,260	9,097
Merchandise and other sales	**29,634**	28,901	27,402	21,156	17,247
Forest product sales	**66,338**	44,828	34,791	—	—
Steel product sales	**17,201**	17,743	13,917	—	—
Income from limited term oil and gas leases	**2,770**	4,428	5,897	9,975	6,522
Interest and other income	**4,228**	4,073	3,397	1,973	1,928
	$329,466	$301,200	$246,147	$138,342	$106,656

Note: The information gives retroactive effect to income tax re-assessments, equity in net earnings of affiliate and tax allocation adjustments.

MANAGEMENT DISCUSSION AND ANALYSIS OF SUMMARY OF OPERATIONS

1975 Compared to 1974

1. Revenue increased by $54.4 million or $22.4% over 1974. Gasoline and other petroleum products, propane and natural gas increases were due primarily to effects of higher selling prices. Forest products division experienced an increased demand for plywood in the latter part of the year as well as some increase in selling prices. Steel products division increase reflects sales for a full year of operations combined with an increase in demand for fabricated goods.

2. Cost of sales increased by $49.2 million or 27.8% over 1974. Lower margins (sales less cost of sales) were experienced throughout most of the Company, especially in areas of operations where regulation has not allowed immediate pass through of product cost increases. Improvement in margins were primarily limited to the steel products division where demand has remained strong.

3. Operating, selling and administrative expense increased by $5.8 million or 15.5% over 1974 due to higher volume of sales and inflationary pressures.

4. Equity in net earnings of affiliate (Canadian Homestead Oils Limited) has shown a strong improvement (a profit of $661,000 versus a prior year loss of $37,637) largely due to increased earnings and to a successful exploration program during 1975 which has added appreciably to Homestead's oil and gas reserves.

1976 Compared to 1975

1. Revenue increased by $28.3 million, 9.4% over 1975. This increase is primarily the result of increased lumber trading in the forest products division and higher natural gas prices in the utilities division. Modest price increases in propane, gasoline and other petroleum products were substantially offset by decreased sales volumes.

2. Cost of sales increased by $24.2 million, 10.7% over 1975. The increased lumber volume in the forest products division and increased cost of natural gas reflecting higher well head prices account for the major part of this increase. Because lumber trading yields a gross margin significantly less than the Company average, and natural gas cost increases essentially paralleled increased selling prices, the increase of both revenues and cost of sales in these divisions resulted in a reduction in the gross margin realized by the Company. Although gross profit increased in 1976, the gross profit margin declined by 1.5 percentage points from 1975.

3. Operating, selling and administrative expenses increased by $5.6 million, 13% over 1975. The expense of an extensive cost control program and unusual bad debt experience during the year substantially account for that part of the increase in excess of inflationary escalation.

4. Depreciation increased by $2.0 million, 34% over 1975. This increase includes $1.3 million being the amortized balance of "excess of cost over net book value of assets acquired", recorded at the date of purchase by Gold Rey Forest Products Inc. In view of the accumulated losses realized in the forest products division since acquisition, this excess cost, generally recorded in anticipation that future earnings will justify such value, was written off during 1976.

CANADIAN HYDROCARBONS LIMITED

DIRECTORS

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President
Grafton Group

Henry E. Dynes
Toronto, Ontario
Chairman & Chief Executive Officer
Traders Group Limited

Robert G. Graham
Winnipeg, Manitoba
President and Chief Executive Officer
Inter-City Gas Limited

James W. McCutcheon, Q.C.
Toronto, Ontario
Senior Partner
Shibley, Righton & McCutcheon

Gordon P. Osler
Toronto, Ontario
Vice Chairman and Chief Executive Officer
British Steel Corporation (Canada) Limited

George C. Solomon
Regina, Saskatchewan
President
Western Tractor Ltd.

Alan Sweatman, Q.C.
Winnipeg, Manitoba
Senior Partner
Thompson, Dorfman, Sweatman

Michael J. Walton
Vancouver, British Columbia
Executive

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Chairman of the Board and President

Anthony C. Rooney
Vice President Finance

Wayne R. Harding
Vice President

C. Roy Beenham
Vice President

John E. Carstairs
Secretary and Counsel

Allan E. Dobson
Assistant Secretary

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Auditors
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